



December 21, 2005

Memorandum

To: Members of the Board

From: Eileen W. Parlow, Assistant Director

Through: Wendy M. Comes, Executive Director

Subject: Accounting for Fiduciary Activities (Tab G)¹

Meeting Objective: To review draft revisions to the exposure draft, *Accounting for Fiduciary Activities*, based upon comments received. The attached revised exposure draft displays the proposed revisions described below. All paragraph numbers refer to paragraph numbers in the revised draft.

1. Disclosure of Audit Opinion Received on Stand-Alone Audited Financial Statements of Fiduciary Activities

At the October 2005 meeting, the Board agreed with staff recommendation that when separate audited financial statements are issued for the fiduciary activity, the fiduciary note of the Federal component entity that administers the fiduciary activity should include (a) disclosure of the audit opinion on the separate audited financial statements of the fiduciary activity, and (b) information on how the reader can obtain a copy of the separate financial statements and the audit opinion thereon.

Staff has drafted the following language, which would apply to the component level of reporting in paragraph 20.

The paragraph below would be inserted immediately after the paragraph that describes quantitative and qualitative criteria for component entities to consider in selecting fiduciary activities to be presented individually.

If separate audited financial statements are issued for an individual fiduciary activity that is presented individually in accordance with the

¹ The staff prepares Board meeting materials to facilitate discussion of issues at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect authoritative views of the FASAB or its staff. Official positions of the FASAB are determined only after extensive due process and deliberations.

criteria described in the preceding paragraph,

- The fiduciary note should disclose whether or not it is the auditor's opinion that the current or most recent financial statements present fairly, in all material aspects, the net assets available at the financial statement date, and the changes in net assets available during the year then ended, in conformity with accounting principles generally accepted in the United States of America.
- The note disclosure should provide information on how the reader can obtain a copy of the financial statements and the audit opinion thereon.

Question for the Board:

Does the Board agree with the draft language above?

2. Separate Financial Statements with a Year-End Other than September 30

At the October 2005 meeting, a majority of the Board agreed with staff recommendation that if separate audited financial statements are prepared with a year-end other than September 30, the note disclosure can provide information from the most recent audited financial statements.

Staff has drafted the following language, which would apply to component level reporting requirements in paragraph 16(e):

[Paragraph 16, new subparagraph (e)]

If the separate audited financial statements for an individual fiduciary activity are prepared with a fiscal year-end other than September 30, the information required in this paragraph may be provided for the fiduciary activity's most recent fiscal year, provided that the information is clearly labeled and is not aggregated with other fiduciary activities.

Staff has also drafted the following addition to paragraph 18:

[Paragraph 18] For component entities with several distinct fiduciary activities, summary financial information required in paragraph 16 should be provided for each fiduciary activity presented individually. Information for fiduciary activities not presented individually (see paragraph 19) may be aggregated, **except as described in paragraph 16(e).**

At the October 2005 Board meeting, Mr. Reid noted that information with a different year-end should not be aggregated on the government-wide Financial Report. Staff has drafted the following language for paragraph 24, which would clarify that total

fiduciary activities should not be aggregated in the government-wide note disclosure:

The fiduciary note disclosure should include a definition of fiduciary activities, a description of the nature of the Federal Government's fiduciary activities, a list of component entities responsible for fiduciary assets, and the total amount of fiduciary net assets for each responsible component entity, **except for any disaggregation required by paragraph 16 (e).** Aggregation of component entities with immaterial amounts of fiduciary net assets is permitted. **Total fiduciary activity for the Federal Government should not be aggregated, because some fiduciary activities are permitted to be reported on a fiscal year other than the fiscal year of the Federal Government as a whole.**

In addition, the following draft language has been added to illustrative government-wide note disclosure in Appendix C:

Total fiduciary activities for the Federal Government are not aggregated, because [component entity X] is/are permitted to report on a fiscal year other than the fiscal year of the Federal Government as a whole.

Question for the Board:

Does the Board agree with the draft language above?

3. **Seized Monetary Instruments**

At the October 2005 meeting, the Board agreed that unless staff discussions with the Department of Justice indicate otherwise, staff should draft language to exclude seized assets by explaining why they do not meet the definition of fiduciary activities. Staff has drafted the following addition to paragraph 13:

Seized monetary instruments should be recognized as assets in accordance with existing standards. Seized property, including seized monetary instruments, is not subject to the reporting requirements for fiduciary activities because it does not meet the definition of a fiduciary activity. In seizure, the Government is asserting a legal right to seize the property. The Government is taking action under due process to eliminate, rather than to uphold, the ownership interest of the non-Federal party. Seized assets, including seized monetary instruments, should continue to be reported in accordance with existing standards.²

Staff has also drafted the following new paragraph 56 in the Basis for Conclusions:

² See SFFAS 3, *Inventory and Related Property*, paragraphs 61 and 69.

The standard clarifies the fact that seized monetary instruments are not subject to the fiduciary reporting requirements because seized assets do not meet the definition of fiduciary activities. In seizure, the Government is asserting its right to the asset, and is taking action to eliminate, rather than to uphold, the ownership interest of the non-Federal party.

Staff has also deleted language referring to seized monetary instruments as fiduciary activity (paragraphs 16 and 31 and the illustrative disclosure in Appendix C).

Question for the Board:

Does the Board agree with the draft language above?

4. Explanation of Exclusions

At the October 2005 Board meeting, Mr. Farrell and Mr. Patton asked staff to strengthen the explanation for the exclusions of payroll withholdings and garnishments and unearned revenue.

Staff has drafted the following revisions to paragraphs 53 through 55 in the Basis for Conclusions:

The Role of Deposit Funds

[53.] Federal component entities report budgetary and proprietary transactions to the OMB and the Treasury FMS using “fund account symbols”, which are sub-components of Federal reporting entities. Fund account symbols are assigned by the Treasury FMS in collaboration with the OMB. Based upon certain characteristics, fund account symbols are classified into “fund groups.” For example, “deposit funds” are a fund group for monies that do not belong to the Federal Government.³ The OMB classifies deposit funds as non-budgetary activities and excludes deposit funds from the Federal budget.⁴ Within the “deposit fund” group established by the Treasury FMS, there are three distinct types: (a) monies withheld from Government payments for goods and services received, including payroll withholdings and garnishments; (b) monies the Government is holding awaiting distribution based on a legal determination or investigation; and (c) deposits received from outside sources for which the Government is acting solely as a banker, fiscal agent or custodian.⁵ Although some fiduciary activities may be

³ Treasury Financial Manual (TFM) Volume 1, Part 2, Section 1535, available on the Internet at <http://www.fms.treas.gov/tfm/vol1/index.html>.

⁴ See FY 2006 U.S. Budget, *Analytical Perspectives*, pp. 372,377 and 378-379

⁵ TFM, Section 1535.

recorded and reported in deposit funds, the use of a deposit fund for an activity does not automatically indicate that the activity meets the definition of fiduciary in this standard. The activity in each deposit fund should be reviewed to determine whether it meets the definition and characteristics of a fiduciary activity in this standard. Also, if an activity is not reported in a deposit fund, that fact does not automatically indicate that the activity does not meet the definition of fiduciary in this standard. Each activity must be evaluated based upon whether or not it meets the definition of a fiduciary activity in this standard.

Exclusions

[54] Payroll withholdings and garnishments appear to meet the definition of fiduciary activities. When an employer withholds an amount from an employee's wages, the employer has a responsibility to forward those amounts to the required recipient. However, this standard excludes payroll withholding and garnishments from the reporting requirements for fiduciary activities because payroll withholdings and garnishments are similar to other unpaid costs of operations and do not warrant special reporting. Because of the pervasive nature and short duration of the activity, the Board does not find it cost-beneficial to require separate identification and reporting of payroll withholdings and garnishments.

[55] Similarly, Federal component entities may hold advances received from customers for future sales of goods or services. Such advances represent unearned revenue. The Department of Defense, in its written response and oral testimony, noted that advances received in the Foreign Military Sales program appear to meet the definition of fiduciary activity. However, this standard excludes unearned revenue from the fiduciary reporting requirements because unearned revenue is a routine operational activity that is pervasive in nature. The Board does not find it cost-beneficial to require separate identification and fiduciary reporting of unearned revenue.

Question for the Board:

Does the draft language above clearly explain the exclusions?

5. Clarity of Amendment to Paragraph 102 of SFFAC 2, *Entity and Display*
Paragraph 33 amends paragraph 102 of SFFAC 2. Paragraph 102 of SFFAC 2 states that "custodial collections do not include deposit funds" and further states that deposit fund collections should be recognized as assets and liabilities. The proposed revision to paragraph 102 of SFFAC 2 was in paragraph 33 of the ED (see text box on next

page) and it was intended to convey the concept that fiduciary assets and liabilities should not be recognized on the balance sheet.

Paragraph 33, as it appeared in the ED:

33. This standard also amends paragraphs 84 and 102 of SFFAC 2, *Entity and Display*, as follows:

[84] The elements most likely to be presented in the balance sheet of a Federal suborganization/organization, program, or the entire government would be as follows:

- **Fund Balance with Treasury.** This represents the amount in the entity's accounts with the U.S. Treasury that is available only for the purpose for which the funds were appropriated. It ~~would~~ **may** also include balances held by the entity in the capacity of a banker or agency for others.
However, Fund Balance with Treasury (FBWT) meeting the definition of fiduciary FBWT should not be recognized on the balance sheet, but should be disclosed in accordance with the provisions of SFFAS xx, Accounting for Fiduciary Activities. ~~This classification would not be included in the financial statements of the U.S. Government.)~~
- [102] Custodial collections do not include deposit funds, i.e., amounts held temporarily by the government (e.g., bidders' earnest money or guarantees for performance) or amounts held by the Government as an agent for others; (e.g., state income taxes withheld from Federal employees' salaries that are to be transferred to the states.) ~~Both of these types of collections can be considered assets and liabilities until they are returned to the depositor or forwarded to the organization entitled to the funds.~~ **should be reported in accordance with the provisions of SFFAS , Accounting for Fiduciary Activities.**

Former Board member Hal Steinberg noted that the proposed revision to SFFAC 2, as written, could be confusing, because some might interpret it to require that all deposit funds be reported as fiduciary.⁶ Staff agrees that it is important to clarify the fact that the proposed standard does not classify funds based upon whether they are recorded and reported as "deposit funds."

Staff recommendation: amend paragraph 102 of SFFAC by deleting rather than revising the following sentence, which refers to deposit fund collections:

~~Both of these types of collections can be considered assets and liabilities until they are returned to the depositor or forwarded to the organization entitled to the funds.~~

⁶ See page 112, October briefing materials.

Question for the Board:

Does the Board agree with staff recommendation?

6. Cost/Benefit Concerns

At the October 2005 meeting, Mr. Dacey expressed an interest in what the Department of the Interior's cost might be to implement accrual accounting for the Indian Trust Funds. Staff sent a letter to Mr. Dan Fletcher requesting this information and has followed up with telephone calls, but Mr. Fletcher has not responded as of the date of this memorandum. A copy of the letter is attached.

7. Technical Changes

The following technical changes do not impact the requirements of the proposed standard:

- a. Made the revisions necessary to change the document from an Exposure Draft to a draft SFFAS, including:
 - updated the Basis for Conclusions to reflect outreach activities, summary of comments received, and Board's response to recommendations in the comments; deleted Alternative Views to the ED;
 - deleted the request for comments by the comment due date (August 2005), the questions for respondents, outdated document footer, and the adjective "proposed" when referring to the standard;
 - changed verb format from the conditional ("would")
- b. Fixed typographical error in paragraph 32 ("accounting" should be "accounted").
- c. Updated illustrative note with dates reflective of proposed effective date of FY 2009.
- d. The roster of FASAB Board members printed on the last page will be limited to those members who were active Board members when the eventual final standard (or new ED) is issued. The list will no longer include former Board members who did not have the opportunity to approve the issuance of the final document or to write a dissent.

Attachments:

Text of staff letter to the Department of the Interior
Revised draft SFFAS with tracked changes

Attachment: Text of Staff Letter to the Department of the Interior

Mr. Daniel L. Fletcher
Associate Director – Financial Statements and Systems
Office of Financial Management
United States Department of the Interior
Office of the Secretary
Washington, DC 20240

November 8, 2005

Dear Mr. Fletcher,

Thank you for your response to the exposure draft, *Accounting for Fiduciary Activities*.

At the October 2005 Board meeting, it was noted that it would be helpful for the Board to have estimated cost information regarding the impact of the proposed standard upon the Department of the Interior if it were implemented relative to the Indian trust funds.

We realize that it may not be possible for you to provide estimated cost information that would distinguish between the costs to implement the proposed accounting standard and the costs to remedy the qualifications of the audit opinions and the material weaknesses that were identified in the most recent (fiscal year 2004) audit reports for the financial statements of the Indian tribal and individual Indian trust funds. If you are able to provide detailed cost information, the Board may find it useful in assessing your response to the exposure draft. The Board plans to address this issue again at its meeting on January 11th and 12th. Please provide any information to Ms. Eileen Parlow by December 18th so that it can be conveyed to the Board members in advance of the meeting. Ms. Parlow can be reached at 202-512-7356 or parlowe@fasab.gov.

Sincerely,

Wendy Comes
Executive Director

Attachment: Revised Draft SFFAS, *Accounting for Fiduciary Activities*

Note to FASAB Website Users:

Working drafts are not distributed to the public and are not posted on the FASAB website.